Chapter 6

Political Agency and Institutions: Explaining the Influence of Left Government and Corporatism on Inequality

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It is well known that wage inequality has increased dramatically in the United States over the last three decades. From 1973 to 1998, the hourly earnings of a full-time worker in the ninetieth percentile of the American distribution (someone whose earnings exceeded those of 90 percent of all workers) relative to a worker in the tenth percentile grew by 25 percent, and the corresponding figure for men only was nearly 40 percent. In the words of Paul Krugman (1996), today America is no longer a "middle-class nation." Wage inequality has increased in most other OECD countries as well, but the extent of this phenomenon varies a great deal. Cross-national differences in levels of wage inequality, in fact, remain as great as they were in the 1970s. In the United States, the worker in the ninetieth percentile earned 4.63 times as much as the worker in the tenth percentile in 1996. In Sweden, on the other hand, a worker in the ninetieth percentile earned only 2.27 times as much as the worker in the tenth percentile.

Inequality is frequently invoked as an explanation for a number of crucial issues in political science. It is often considered a determinant of processes as diverse as the decline of electoral turnout (Rosenstone and Hansen 1993; Verba, Nie, and Kim 1978), the increase in the support of extreme-right parties (Betz 1994), or the likelihood of political conflict (for a review, see Lichbach 1989). At the same time, recent work by labor economists demonstrates that supply and demand factors alone cannot account for cross-national variation in wage inequality (Blau and Kahn 1996; Freeman and Katz 1995; Gottschalk and Smeeding 1997). Most analysts would agree that political factors influence inequality in significant ways. Because inequality has political determinants and political consequences, it deserves to be a central concern of comparative political economy.

The politics of inequality are fundamentally influenced by questions about political agency and institutional constraints. A large and influential literature in comparative politics has emphasized partisan differences as a determinant of political and economic outcomes (James Alt [1985] and Douglas Hibbs [1977, 1987] are commonly cited examples). According to this framework, political agency is indeed important, and different parties promote distinct economic outcomes (in terms of equality, unemployment, inflation, and so on). Other authors, however, have emphasized the role of institutions as a mediating force. Institutions, they argued, shape the ability of political actors to affect the economy (see, for example, Steinmo, Thelen, and Longstreth 1992). In the following pages, I argue that to understand the relationship between political agency and inequality we must do two essential things: separate the effects of government partisanship and policy on the economy and assess the influence of political agency once we account for the mediating role of institutions.

A number of analysts of the political economy of industrialized democracies have argued that the partisan nature of governments should influence the levels of inequality in the economy (see, for example, Pontusson, Rueda, and Way 2002; Rueda and Pontusson 2000; Wallerstein 1999). While sharing the general partisan assumptions presented in this literature, I wish to emphasize in this chapter that governments do not possess the ability to transform the wage distribution directly. In other words, governments, whether conservative or liberal, cannot legislate a particular amount of inequality. They must rely on the design and implementation of policy to accomplish any degree of redistribution. To assess accurately the influence of government partisanship, therefore, we must explicitly separate the effects of political agency on policy and the effects of policy on inequality.

The second element in the argument I present in this chapter is related to the role of institutions as factors affecting political agency. I argue that, in an analysis of inequality, the effects of government partisanship on policy and the effects of policy on economic outcomes are contingent on institutions. The starting point for my analysis is that partisan differences do affect the policies that governments are likely to promote. But I argue that these partisan differences are influential only when some institutions are in place. More specifically, I argue that even when they are committed to redistribution, leftist governments do not promote egalitarian policies unless they are convinced that the institutional context allows these policies to affect economic outcomes.

Wage Inequality in the OECD

This chapter focuses on the effects of the relationship between political agency and institutions on the lower half of the wage distribution. As pointed out by Andrea Brandolini and Timothy Smeeding (this volume) and Pablo Beramendi and Thomas Cusack (this volume), there are significant differences in the incidence of inequality across OECD countries depending on what kind of income we look at. Nevertheless, wages are the most important component of individual and household income—and the wages of those in the lower half of the distribution are particularly important to left parties. An analysis of the influence that governments exert on inequality should therefore emphasize those with the lowest wages. It is reasonable to assume that if left government affects inequality, it does so by raising the wage levels of the most needy.

Table 6.1 summarizes the wage inequality data that serve as the dependent variable for my analysis. For each country, the table provides the mean value for wage inequality at the lower half of the wage distribution (the 50/10 ratio) for the entire period 1973 to 1995, as well as the percentage change from the earliest to the most recent observation.

It should be noted at the outset that these inequality measures refer to gross income from employment for individuals: they ignore other sources of income (government transfers, self-employment, income from capital, and so on) and exclude the distributive effects of taxation and income pooling within households. The data also are restricted to full-time employees, except in the case of Austria. Since part-time employees invariably earn less, on an hourly basis, than full-time employees, the figures in table 6.1 understate the extent of wage inequality in the other countries. And because the incidence of part-time employment has increased in most OECD countries since the early 1980s, these figures also understate the upward trend in wage inequality.

Table 6.1 reveals important cross-national variation in wage inequality. In these sixteen countries, the average 50/10 ratio for the 1973 to 1995 period was 1.64. In other words, a person in the fiftieth percentile of the wage distribution (the wage median) earned, on average, 1.64 times as much as a person in the tenth percentile. Sweden, with an average 50/10 ratio of 1.33, stands out as the OECD country with the most compressed lower-half wage distribution. While the Scandinavian countries fall within a narrow range of very compressed lower-half wage dis-

Table 6.1 Means and Percentage Changes in Inequality

Country and Years Covered	50/10 Ratios Mean	50/10 Ratios Percentage Change
Australia, 1976 to 1995	1.66	3.1
Austria, 1980 to 1994	1.96	0.0
Belgium, 1986 to 1993	1.45	−1.4
Canada, 1973 to 1994	2.30	9.1
Denmark, 1980 to 1994	1.40	−2.8
Finland, 1977 to 1995	1.46	−10.2
France, 1973 to 1995	1.66	−5.7
Germany, 1984 to 1995	1.63	−11.9
Italy, 1986 to 1995	1.42	−3.4
Japan, 1975 to 1995	1.70	−6.3
Netherlands, 1977 to 1995	1.56	5.8
Norway, 1980 to 1994	1.39	−6.4
Sweden, 1975 to 1995	1.33	0.0
Switzerland, 1990 to 1995	1.61	0.0
United Kingdom, 1973 to 1995	1.78	1.5
United States, 1973 to 1995	2.00	11.0
Average	1.64	−1.1
Standard deviation	0.26	6.38

Source: OECD (1996, 61–62) for all countries except the United States; for the United States, OECD (1993, 161; 1996, 103).
Note: The percentage changes measure the variation from earliest to latest available observation in the country series.

tributions, the continental European countries included in this data set (France, Belgium, Germany, Italy, the Netherlands, and Switzerland) can be classified as a group with inequality levels slightly below the OECD average. The exception is, of course, Austria, which belongs at the opposite end of the spectrum with the United States, the United Kingdom, Japan, and Canada. All these countries exhibit considerably larger-than-average levels of inequality at the lower half of the wage distribution.

Turning to change over time, the variation in the data is also very noticeable. From the earliest to the most recent observation available for each country, there are large increases of 50/10 inequality in the United States, Canada, and Australia. However, lower-half wage inequality fell quite significantly in Germany, Finland, Norway, and Japan.

Table 6.1 shows the high degree of cross-country and over-time variation that exists in the sample. What accounts for these different patterns?

In the following pages, I argue that the interplay of partisanship, corporatism, and policy is an important part of the story.

The Puzzle: Government Partisanship and Inequality at the Lower Half of the Wage Distribution

The starting point for this chapter's exploration of the determinants of wage inequality is the hypothesis that the partisan nature of governments influences wage inequality. Governments can influence a country's wage distribution through a variety of policies (for example, those affecting minimum wages, social wages, taxes, and so on). The argument supporting the existence of a relationship between government partisanship and inequality at the lower half of the wage distribution can be explained in very simple terms. It hinges on the proposition that the policy preferences of left parties raise the wage floor for competition in the labor market. If there is a legislated minimum wage, for example, left governments are likely to set the minimum wage closer to the median wage than right governments. Another example would be the tendency of left governments to favor higher levels of social wages, therefore curtailing the inegalitarian effects of unemployment, and the general tendency of left governments to boost the relative bargaining power of unskilled workers.

In one of the few existing political analyses of inequality at the lower end of the distribution, Jonas Pontusson, David Rueda, and Christopher Way (2002) analyzed the determinants of 50/10 ratios to test whether left governments do in fact raise the relative market power and wages of poorly paid workers. They did this through a set of regressions in which the relationship between Thomas Cusack's (1997) measure of government partisanship and the levels of 50/10 inequality is explored. I reproduce their main results in the first column in table 6.2.

The results in table 6.2 show that government partisanship does not significantly influence inequality at the lower half of the wage distribution.[1] As Pontusson, Rueda, and Way recognized, this is a puzzling finding. In this regression, the coefficient for government partisanship is positive (as expected, social democratic governments would be associated with lower levels of wage inequality), but it does not come close to reaching statistical significance. These results therefore offer little support for the hypothesis that left parties promote relative wage gains for poorly paid workers by setting a floor for competition in the labor market.

Since the lack of significance of the partisanship variable could be interpreted as a result of the presence of country and time dummies (the

Table 6.2 The Effects of Government Partisanship on Inequality in the Lower Half of the Wage Distribution

Constant	—	**–.125**
		(.061)
		.041
Lagged dependent variable	**.484**	**.980**
	(.065)	(.015)
	<.001	*<.001*
Cabinet partisanship	**.003**	**.008**
	(.005)	(.005)
	.593	*.112*
Unemployment rate	**–.005**	**–.001**
	(.004)	(.003)
	.166	*.705*
Trade with less-developed countries	**–.001**	**–.005**
	(.006)	(.004)
	.814	*.188*
Female labor force participation	**–.025**	**.008**
	(.031)	(.013)
	.412	.526
Private sector services	**–.002**	**.027**
	(.034)	(.009)
	.950	*.004*
Union density	**–.018**	**–.006**
	(.010)	(.003)
	.086	*.078*
Wage bargaining centralization	**–.028**	**.004**
	(.007)	(.003)
	<.001	*.164*
Public sector employment	**–.068**	**.010**
	(.020)	(.005)
	.001	*.047*
Observations	203	203
Adjusted R-squared	.99	.99
Fixed effects	Yes	No

Source: Author's compilation; see appendix for variable details and data sources.

Note: All entries are OLS estimates. Numbers in bold are estimated coefficients; numbers in parentheses are their panel-corrected standard errors; numbers in italics are p-values from two-sided t-tests.

regression in the first column includes dummies for all countries[2] and for the time periods[3]), I also present the results of an identical regression without fixed effects. In this regression, which assesses the sort of cross-national variation excluded by country dummies, the effects of government partisanship are still insignificant.

Pontusson, Rueda, and Way further explored the wage floor hypothesis by developing a very preliminary analysis of the relationship between government partisanship and income replacement policies, on the one hand, and that between income replacement policies and wage inequality, on the other. They plotted average income replacement rates in the period 1985 to 1991 against each country's average partisanship score for 1970 to 1990.[4] And then they plot 50/10 ratios in 1991 against the average unemployment replacement rates. Their analysis suggests that there is a very weak association between left government and the generosity of unemployment compensation and that the relationship between unemployment compensation and 50/10 compression is even weaker. In other words, both steps in the argument linking left government to egalitarianism via a wage floor effect seem to falter.

It is clear, however, that the connection between government partisanship and policy, on one side, and between policy and wage inequality, on the other, needs more attention. Pontusson, Rueda, and Way recognized that their analysis of the effects of income replacement rates on inequality (as well as their relationship to government partisanship) is very rudimentary. Income replacement policies are not the only tool at the disposal of a government to influence the market power and wages of poorly paid workers. In fact, since replacement rates do not reflect the percentage of workers who are entitled to unemployment benefits, there are reasons why this policy is in fact not the most appropriate for assessing the influence of governments on inequality.[5] The analysis needs to be extended to other policies and its methodology needs to be improved. More systematic tests of the relationships among partisan governments, policies, and wage outcomes must be performed. These are the objectives of the analysis that I develop in this chapter.

The Argument: Separating the Effects of Partisanship from the Effects of Policy and Assessing the Role of Institutions

The argument supporting the existence of a relationship between government partisanship and inequality rests on the proposition that the policy preferences of left parties raise the wage floor for competition in the labor market. There are two fundamental points I wish to make in this chapter. The first has to do with the connection between governments and inequality. It is common for comparative political economists to test the existence of associations between the partisan nature of governments and levels of inequality. Governments, however, do not possess the ability to transform the wage distribution directly. They must rely on the design and implementation of policy to accomplish any degree of redistribution. If we are interested in an accurate assessment of the relationship between partisanship and inequality, therefore, it is imperative that we disentangle the effects of partisanship and policy. We must explore first whether government partisanship affects policy and then whether policy affects inequality.

The second point I make in this chapter concerns the role of institutions as factors affecting political agency. The influence of institutions on political processes has been emphasized by a great number of scholars (see Hall and Taylor 1996; Pontusson 1995; Steinmo, Thelen, and Longstreth 1992). Regarding inequality, I argue that the effects of government partisanship on policy and the effects of policy on economic outcomes are contingent on institutions. In other words, even when they are committed to redistribution, partisan policymakers do not promote egalitarian policies unless they are convinced that the institutional context allows these policies to affect economic outcomes. I focus on those institutions related to the labor market.

There are reasons to believe that the effects of policy on wage-distributive effects are contingent on an important set of labor market institutions: those related to the existence of corporatism. According to Peter Katzenstein, three traits define corporatism: "an ideology of social partnership expressed at the national level; a relatively centralized and concentrated system of interest groups; and voluntary and informal coordination of conflicting objectives through continuous political bargaining between interest groups, state bureaucracies and political parties" (1985, 32).[6] Arguably, all these arrangements constrain the ability of governments to influence the distribution of wages. Put more positively, they enable the social partners to negotiate effective wage floors and therefore reduce their reliance on government policy (such as minimum-wage legislation) for this purpose. In this context, it is logical to assume that the link between policy and inequality would actually be very weak in corporatist countries. Furthermore, since policymakers understand that policy is ineffectual and that inequality is in some ways taken care of by corporatist institutions, it is also logical to hypothesize that the influence of government partisanship on policy would be very weak when corporatism is high.

It is important to emphasize here that my claims about the influence of corporatist structures contradict generally accepted views about the comparative political economy of industrialized democracies. This literature rests on the argument that corporatist structures and left government act in synergy to promote certain political and economic outcomes. In Geoffrey Garrett's words, "social democratic corporatist regimes are based on a virtuous circle" (1998, 5). Left governments promote policies that protect labor, while unions moderate their wage demands and promote the absence of social strife. In an argument more specifically related to the topic of this chapter, Pablo Beramendi and Thomas Cusack maintain that "high levels of wage bargaining coordination facilitate the implementation of left-wing policy," while "the absence of coordination between capital and labor facilitates the implementation of right wing preferences and constrains the egalitarian effects of left-wing policy" (2004, 16; see also Beramendi and Cusack, this volume).

My argument challenges this interpretation and maintains that high levels of corporatism make the social partners capable of limiting wage inequality directly. As a consequence, corporatist structures constrain the impact of parties on public policy and therefore mute the impact of partisanship on the lower half of the wage distribution.

The Explanatory Variable: Government Partisanship

The government partisanship measure used in my analysis attempts to capture the ideological position of governments in relation to a left-right continuum.[7] Two variables are needed for the construction of these measures: one that reflects the presence of parties in government and another that measures their ideological characteristics. There are, however, important questions surrounding the operationalization of both of these variables. There is first the issue of how to measure the influence of parties in government.[8] One possibility is to take into consideration the proportion of cabinet seats that all parties in government possess. Once a party is in government, however, the support it enjoys may be influenced not only by its position in the cabinet but also by the degree of support it enjoys in parliament.[9]

Regarding the influence of the second factor on government partisanship, the measurement of party ideological positions is also not completely straightforward. Assessments of left-right party positions are typically based on two different measures: the analysis of expert opinions and the analysis of party manifestos. Although there are no perfect measures, those based on expert opinions have particularly significant weaknesses.[10] They are produced from surveys that are administered rarely and that may be interpreted differently in different national contexts (for a more detailed explanation of this argument, see Gabel and Huber 2000). In addition, expert opinions about party positions do not reflect changes through time (McDonald and Mendes 2001). Perhaps more important, partisanship data based on expert opinions are vulnerable to the criticism that they are endogenous. Particularly in analyses of policy and economic outcomes, it can be argued that expert opinions in fact reflect the very same policy and economic outcomes we are trying to present as dependent variables.

I therefore use a measure of government partisanship based on data extracted from party manifestos to assess a party's left-right position. This variable relies on party programs for the codification of policy emphases. For party positions, the policy emphases in election programs are codified into twenty-six categories. The categories are then summarized in a left-right index.[11] For the construction of government partisanship, a party's average left-right position is then multiplied by its cabinet weight (which is measured as the proportion of parliamentary seats that parties in coalition governments have).[12]

The Mediating Variables: Policy

As mentioned earlier, the argument supporting the existence of a relationship between government partisanship and inequality rests on the proposition that the policy preferences of left parties raise the wage floor for competition in the labor market. I examine four policies that partisan governments can use to do this: minimum wages, government consumption, taxes on labor income, and taxes on corporate income.

Statutory Minimum Wages

Minimum-wage policies are not uncontroversial. Those who defend them argue that they limit labor market excesses and increase the wages of the lowest-paid to a socially acceptable level. Those who oppose them argue that their effect is in fact an increase in unemployment, resulting from the pricing out of low-skilled workers (for an explanation, see Dolado et al. 1996). In relation to inequality, the consequences of minimum wages are, at one level, very straightforward. The setting up of a minimum wage makes those who previously had earnings below it automatically earn more. In this sense, minimum wages can promote equality simply by raising the wages of the poorest workers. The OECD in fact found that "those countries with higher minimum wage rates relative to the median have less earnings dispersion and a lower incidence of low pay" (1998, 32). The scholarship on the effects of minimum wages is, however, not unambiguous (for an overview, see OECD 1998, annex 2.B).

For this chapter's analysis, I use the ratio of minimum wage to average wage (for data sources, see the appendix). Clearly, the ratio of minimum wages to average earnings is not a perfect measure.[13] It is, however, the most commonly used measure in analyses in economics and political science, and it is a useful tool to help us understand whether left governments promote equality at the lower half of the wage distribution.

There is an additional complication when measuring minimum wages. As pointed out by Juan Dolado and his colleagues (1996), minimum wages are set up in several ways in industrialized democracies. First, a statutory minimum can be set by government (sometimes in consultation with employers and unions). This is the case in France, Spain, and the Netherlands, among others. Second, a minimum wage can be set as part of collective bargaining at the national level. Third, different minimum wages can be determined in collective agreements, as is the case (with some national differences) in Germany, Italy, Austria, Switzerland, Sweden, Norway, and Finland (for a more detailed explanation, see Dolado et al. 1996; OECD 1998). Given the emphasis of this chapter's analysis on the role of government in determining inequality, only statutory minimum wages should be used as a variable. For countries where the government does not set the minimum wage, the ratio of minimum wage to average wage is set to zero (for details, see the appendix).

Government Consumption

The provision of welfare state services represents an important way in which governments may influence inequality. Welfare services provide a way to redistribute wealth to the poor and insure them against labor market risks (Moene and Wallerstein 2003). There are, then, two ways in which government consumption can affect inequality.[14] First, it can insure workers against risks. As argued by Gøsta Esping-Andersen (1990), welfare programs reduce people's dependence on employment as a source of income. Following Torben Iversen and Thomas Cusack (2000), government consumption also directly reduces inequalities in people's access to education, health care, and so on.[15] As such, it provides the services that allow workers with low wages to increase their income.[16]

Left government is therefore expected to promote higher levels of government consumption. And government consumption is expected to decrease inequality, since higher levels of these policies increase worker skills and strengthen the bargaining power of wage earners at the bottom of the wage hierarchy.[17]

Taxes on Labor Income and on Corporate Income

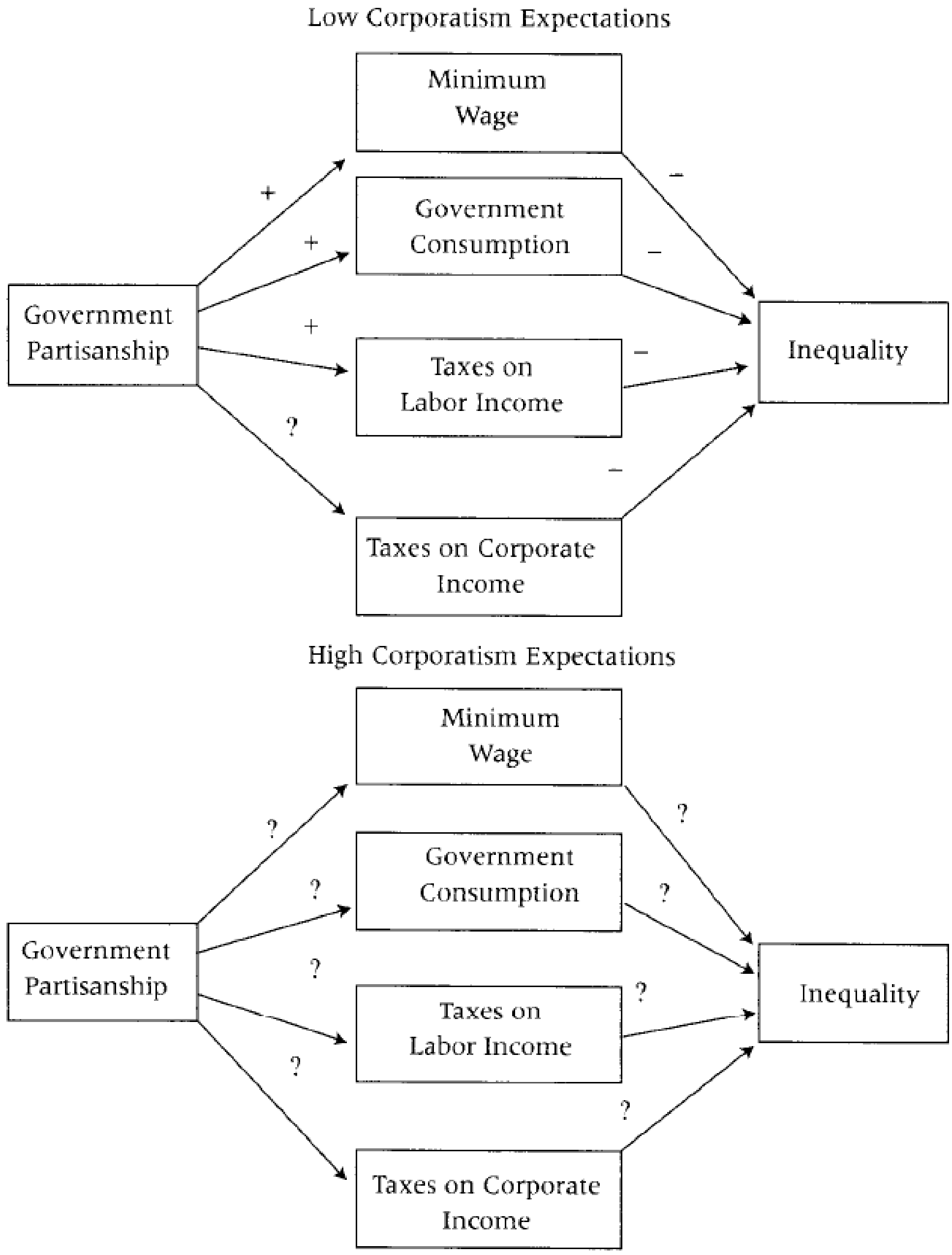
OECD governments claim more than one-third of the total annual output of their respective countries to finance their expenditures. The politics of redistribution (and therefore the politics of inequality) are related to generating revenue just as much as they are to allocating resources.[18] I use measures of the tax rate on labor income and on corporate income (for data specifications and sources, see the appendix).

The relation between government partisanship and taxes on labor income and that between taxes on labor income and inequality are straightforward. Left governments tend to promote higher taxes on labor income because they need greater revenues to sustain a comprehensive welfare state (Cusack and Beramendi 2003; Garrett 1998). The relationship between left government and taxes on corporate income, on the other hand, is not as simple. Since the early 1970s, left governments in the OECD have faced an important challenge: an increase in the internationalization of the economy. As it is conventionally argued, in a world characterized by globalization, owners of mobile assets have the ability to move to markets that provide the highest returns. High levels of mobility (and the threat of exiting an economy) lead to lower taxes on mobile assets (mostly capital) (Ganghof 2001; Gordon and Mackie-Mason 1995).[19] Given the limitations faced by left government in open economies, this chapter's expectations about the influence of government partisanship on taxes on corporations need to be transformed. It is still possible for taxes on corporations to affect inequality, but it is more uncertain, given capital exit threats, to expect that left governments would increase corporate taxation (regardless of institutional configurations).

It is important to emphasize here that the measure of wage inequality employed in this chapter does not allow us to assess the direct impact of taxes on inequality. My dependent variable measures income from employment and ignores government transfers and taxation. It is well known, however, that, in addition to direct effects, taxation influences inequality through second-order effects (Atkinson and Stiglitz 1980; Beramendi 2001). Very simply put, taxes do not only (or even mainly) affect inequality through a process of direct redistribution. They also affect the behavior of individuals who modify their actions in anticipation of the effects of taxation on disposable income. The second-order effects are naturally similar to the first-order ones described in the previous paragraph. The results presented here reflect these second-order effects of taxation, even though the inequality measure used in this chapter is restricted to wages.

Figure 6.1 summarizes the theoretical claims outlined in the previous sections. When corporatism is low, the relationship between government

Figure 6.1 Theoretical Claims



Source: Author's compilation.

partisanship and policy is characterized by a plus sign. This means that leftist governments are expected to raise minimum wages, government consumption levels, and taxes on labor income. Government partisanship has an uncertain effect on taxes on corporate income because of capital's exit threat. When corporatism is low, it is also expected that all the policies of interest will be associated with decreases in inequality. When corporatism is high, on the other hand, because the institutional context enables the social partners to negotiate effective wage floors and therefore reduces their reliance on government policy, the effects of policy on inequality are uncertain. Since left governments do not promote egalitarian policies unless they are convinced that the institutional context will allow these policies to affect economic outcomes successfully, government partisanship is also expected to have an uncertain effect on policy when corporatism is high.

Methodology and Control Variables

I use annual data from a selection of OECD countries from 1973 to 1995 and present ordinary least squares (OLS) results.[20] The pooled data significantly increase the number of observations and therefore allow me to test more complex causal models. There are, however, some complications.

Nathaniel Beck and Jonathan Katz (1995, 1996) proposed a method that produces consistent standard errors estimates in the presence of panel heteroscedastic errors. Since their recommendations have been widely followed in the recent comparative political economy literature, I ran the regressions with panel-corrected standard errors (PCSE).[21]

I include country fixed effects in my analysis. Fixed effects deal with country-specific omitted variables by introducing a unit dummy per cross-section. This seems the right strategy since our general understanding in comparative political economy is that there are country-specific factors that are difficult to introduce into the model (specific historical circumstances, difficult-to-capture institutional developments, and so on). Fixed effects are a powerful tool because they pose a hard test for any given hypothesis.[22] In this case, they are almost a necessity. The OECD wage data are drawn from a variety of sources (household surveys, employer surveys, tax registers, and social security records) and do not cover exactly the same populations. In *Employment Outlook*, the OECD explicitly warns the reader that its wage inequality data are not comparable across countries. Estimating country fixed effects means that the results reported here do not take into consideration cross-country variation. (They are, in fact, an aggregate of within-country effects.)

I ran two sets of regressions. In the first set, I regressed government partisanship and a number of control variables (specified later) on policy (minimum wages, government consumption, taxes on labor income, and taxes on corporate income). In the second set, I regressed the policies and a number of control variables (again specified later) on inequality.[23]

The main hypotheses in this chapter involve the existence of an interaction between corporatism and government partisanship, on the one hand, and between corporatism and policy, on the other. This interaction is introduced into equation 5.1 in the conventional way: both terms of the interaction are introduced into the equation on their own and also interacted.

It was important to check that there was not a simultaneity/endogeneity problem between the two sets of regressions in the analysis (since I was running them independently). If there was such a problem, two-stage least squares (2SLS) would have been required. A series of Hausman's specification error tests showed that there was no simultaneity-endogeneity problem, and therefore no need for a 2SLS model (Gujarati 1995, 669–73).

Control Variables for the Analysis of Policy

Although they are not related theoretically to my main claims, there are a number of variables that need to be included in the analysis (for details and data sources, see the appendix). In some cases, opposing claims about their influence over government partisanship have been provided in the literature, and in all cases there are strong theoretical or empirical reasons to believe that they affect the outcomes I am interested in analyzing.

> *Union density and bargaining centralization:* Both because of their direct involvement in industrial relations (negotiations covering work regulations and wages being the most clear examples) and because of their capacity to influence political parties, the characteristics of unions and employers reflected in these variables need to be explicitly assessed.[24]

International and financial openness: There are two contradictory accounts of the effects of internationalization on partisan politics. There is first a large literature suggesting that growing levels of international openness, integration, and interdependence result in a blurring of partisan differences caused by the inability of social democratic parties to produce policies that do not conform to market forces (see, for example, Iversen 1996; Moses 1994; Scharpf 1991). Then there are some authors who argue either that international forces do not affect some partisan differences (see Boix 1998; Garrett and Lange 1991) or that they actually have strengthened the influence of partisanship on policies and economic outcomes (Garrett 1998).

Government debt: Government debt is introduced into the analysis as a measure of the possible limitations affecting a government's choice of policy. The general argument is that governments with more debt have fewer resources at their disposal and that this affects spending and taxing strategies.[25]

Unemployment: The rate of unemployment represents a measure of the need for some of the policies emphasized in the chapter. Numerous authors have argued that the increasing levels of some social policies simply result from increasing needs, whether demographic, economic, or other (see Cutright 1965; Wilensky 1975).

GDP growth: Most analyses of economic policy include a measure of economic growth. In this chapter's analysis, this is particularly relevant because it is important to control for the effects of macroeconomic growth on the behavior of governments.

Control Variables for the Analysis of Wage Inequality

Given the nature of the outcomes to be explained (inequality at the lower half of the wage distribution rather than policy), some of the control variables for this portion of the analysis are different from those in the previous section (see the appendix for details and data sources).

Unemployment: There are two potential effects of unemployment on inequality. First, the basic insight of the literature on labor market segmentation is that unskilled, low-paid workers are more readily substitutable than more-skilled, high-paid workers, and consequently that their bargaining position is more immediately and more adversely affected by unemployment (Bradbury 2000; Galbraith 1998). On the other hand, employers are more likely to lay off unskilled than skilled workers during economic downturns. To the extent that it entails a disproportionate loss of low-paid jobs, an increase of unemployment produces wage compression by altering the composition of the labor force.

Trade with less-developed countries: Adrian Wood (1994) argued that much of the trend toward increased wage inequality in the OECD countries in the 1980s can be attributed to an increase in trade with less-developed countries. The basic logic of Wood's analysis is that by importing less-skill-intensive goods from low-wage countries, OECD countries are essentially importing low-skill labor, which puts downward pressure on the relative wages of the unskilled.

Female labor force participation: Higher female labor force participation can be associated with higher inequality for several reasons. There is first the influence of wage discrimination (Blau and Kahn 2000). Also, to the extent that women are on average less educated and have less work experience than men, an increase in the proportion of the total labor force made up of women represents an increase in the relative supply of unskilled or less-skilled labor (Svensson 1995; Topel 1994).

Private service employment: It is often argued that wage inequality and private service employment are associated. As Torben Iversen and Anne Wren (1998) pointed out, the scope for productivity growth in services is limited, pricing closely reflects labor costs, and demand for these services is highly price-sensitive. If the assumption that the production of personal services with a high content of unskilled labor is tightly constrained by labor costs is relaxed, however, the opposite association between wage inequality and private service employment would result.

Union density: Several factors contribute to more compressed wage distributions in unionized firms or sectors—among them, the fact that unions approximate the logic of democratic decisionmaking and that they have a strong interest in curtailing wage setting based on the subjective decisions of foremen and managers.

Wage-bargaining centralization: The standard argument linking centralization to wage compression asserts that centralization facilitates the reduction of interfirm and intersectoral wage differentials, since it means that more firms and sectors are included in a single wage settlement. Additionally, it can be argued that centralization produces wage compression by altering the distribution of power among actors (as suggested by Michael Wallerstein [1999], this would follow a median voter logic) and by making bargaining more transparent.

Government employment: The size of the public sector (government employees as a percentage of the total labor force) is often considered to be negatively associated with wage inequality. Sheltered from competition in product markets, public sector employers are more directly exposed to political pressures favoring equality and robust wage growth (Garrett and Way 1999).

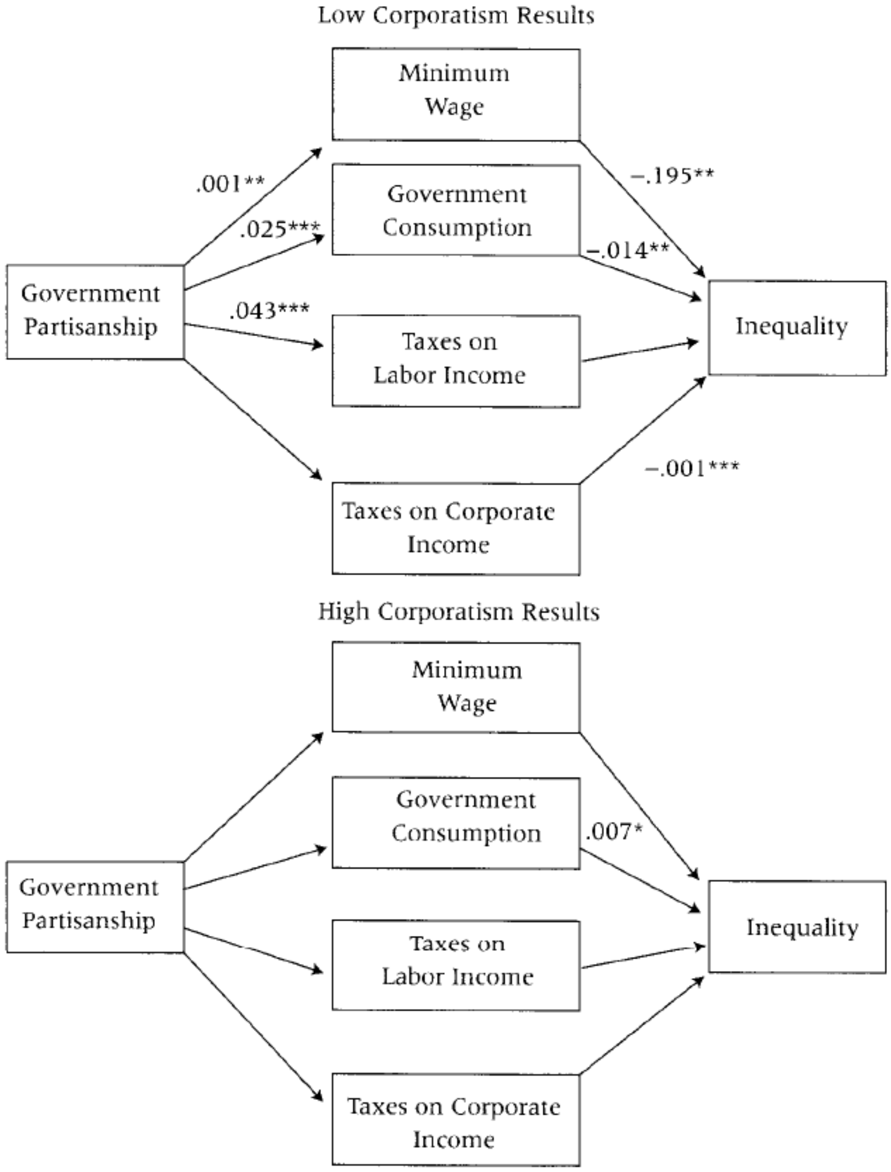
Results

Figure 6.2 presents the results of this chapter's analyses. Because so many regressions must be run (one for the relationship between government partisanship and each policy, one for the relationship between each policy and inequality), only the results for the variables of interest (partisanship and policy) conditional on the levels of corporatism are reported in the figure. The results for the variables used to calculate these conditional effects, as well as results for all control variables, can be consulted in table 6A.1. The figure reflects the two sets of relationships hypothesized in this chapter when corporatism is low and when corporatism is high. In each scenario, there are causal arrows from government partisanship to the policies, and then there are causal arrows from the policies to inequality at the lower half of the wage distribution. The numbers next to the arrows represent the coefficients for these variables in the regressions I ran. The asterisks signify the statistical significance in the usual manner (*** if $p < .01$; ** if $p < .05$; and * if $p < .10$). The p-values were calculated using the panel-corrected standard errors (see table 6A.1). The absence of any coefficient estimates means that the variable was statistically insignificant.

Conditional effects are calculated in the following way. I identify the range of variation in the corporatism variable and use the lowest and highest values. Low corporatism is defined as the score of the United States from 1976 to 1995 (.01) and high corporatism as that of Sweden from 1973 to 1987 (.99). The estimates for the coefficients and the standard errors in figure 6.2 represent the conditional effects when corporatism is high or low.[26]

Going back to the theoretical claims summarized in figure 6.1, the relationship between government partisanship and the first three policies (minimum wage, government consumption, and taxes on labor income) was expected to be positive and significant when corporatism was low. The relationship between government partisanship and taxes on corpo-

Figure 6.2 Conditional Effects



Source: Author's compilation.

* $p < .10$; ** $p < .05$; *** $p < .01$

rate income, on the other hand, was uncertain (given the threat of capital flight). Looking now at the results in figure 6.2, we see that these expectations are confirmed. It is in fact the case that left government is associated with high minimum wages, government consumption, and taxes on labor income when the institutional context allows policies to have an effect on inequality. The influence of partisanship on taxes on corporate income is statistically insignificant even when corporatism is low. It seems that capital-exit threats are indeed powerful enough to stop left governments from taxing corporate income.

Still when corporatism is low, but now turning to the relationship between policy and inequality, my expectations here were simple. In figure 6.1, I hypothesized that all policies would have significant and negative effects on inequality. Figure 6.2 presents strong support for these hypotheses. As expected, the absence of corporatism makes policies very effective at reducing inequality. Increases in the minimum wage, government consumption, and taxes on corporate income are significantly related to decreases in inequality at the lower half of the wage distribution. The only exception is the influence of taxes on labor income (which is insignificant). The results show that second-order effects are present when we look at the relationship between taxes on corporate income and inequality, but not when we look at the influence of taxes on labor income.

The results for the partisanship and policy variables when corporatism is high are also presented in figure 6.2. Again going back to figure 6.1, the expectations for these relationships were straightforward. When corporatism is high, it was hypothesized, the actions of the social partners in the labor market "take care" of wage compression. Corporatist institutions set up baselines for wages that leave little room for policy to affect inequality. Left politicians understand the role of the social partners and are satisfied with the level of equality they promote. Partisan policies are more difficult in these circumstances. In figure 6.2, it seems clear that this is indeed the case when corporatism is high. The results show that almost all relationships are insignificant. Neither the influence of policy on inequality nor that of partisanship on policy are of importance. The only exception is the effect of government consumption on inequality. Although the influence of this variable is small (in terms of both the size of the coefficient and the level of significance), it is not negligible. Interestingly, the sign of this relationship is positive, which means that higher government spending on education, health, and transfers is in fact associated with an increase in inequality. This seems to indicate that the effects of government services raise the wage of the median worker more than that of the poorest workers at the bottom of the distribution.

Conclusions

It is perhaps appropriate to conclude the chapter by briefly summarizing its main points. The main focus of the chapter was the relationship between government partisanship, policy, and wage inequality at the lower half of the wage distribution. The analysis was motivated by the absence of government partisanship effects on inequality previously found in the literature. My expectations are theoretically derived from conceptually differentiating between political agency and the role of institutions. I focus on the role of corporatism as a factor mediating the influence of leftist governments. I presented a set of hypotheses based on the (not necessarily intuitive) argument that left government does not promote policies to affect outcomes that the social partners have already "taken care of."

It is also important to point out that this chapter's argument about the relationship between corporatism and left government contradicts the generally accepted wisdom about left power. An influential literature in comparative political economy argues that corporatist structures and left government act in synergy to promote certain political and economic outcomes. My results show that the virtuous cycle of corporatism and left government works in a different way. It is not necessarily the case that the actions of corporatist partners and left governments reinforce each other. Regarding inequality, I show that the relationship between left governments and corporatism is in fact complementary: when institutions cannot provide enough equality, left governments pick up the slack.

Admittedly, this analysis represents an oversimplification of the relationship between government partisanship and corporatism. I have treated corporatism as an exogenous variable, a set of stable institutional constraints that affect political agency. In this respect, my analysis reproduces the approach of most existing analyses of inequality in industrialized democracies (see, for example, Beramendi and Cusack 2004; Rueda and Pontusson 2000; Wallerstein 1999). It is clear, however, that corporatist structures, although stable in time, are deeply connected to government partisanship developments. Left governments do not affect inequality directly only; they can also promote corporatist structures that may have more of an effect on labor market inequalities in the long run. An important question for further research, therefore, is whether endogenizing the relationship between corporatism and left government affects our understanding of the determinants of wage inequality.[27]

Finally, what does this analysis mean for inequality in the future? An optimistic interpretation is possible. Although it is clear that market forces have generated more inequality in industrialized democracies, there is nevertheless no uniform or universal trend. Previous analyses offered little comfort on this score. Pontusson, Rueda, and Way (2002), for example, argued that institutional developments since the mid-1980s have not been favorable to wage equality. Most importantly, numerous authors have noted that centralized wage bargaining and union membership have experienced important declines in many OECD countries. From the perspective of this analysis, however, a more positive argument can be offered. This chapter shows that when institutional factors become less relevant, political agency picks up the slack. The countervailing effects of left government can still produce significant levels of labor market equality. The decline of some institutional factors can therefore be an opportunity for political agency to become more influential.

Appendix

Definition of Variables and Data Sources

Centralization: Wage-bargaining centralization as measured by Torben Iversen. Higher figures signify more centralization. See Torben Iversen (1999) for a complete specification. These figures have been transformed into a moving average so that the value for a given year is the average of the actual value for that year and the previous four years.

Corporatism: Hicks-Kenworthy (1998, 1642–43) composite corporatism measure. It measures business centralization, wage-setting coordination, cooperation between government and interest groups, tripartite neocorporatism, cooperation between investors and firms, and cooperation between labor and management.

Female labor force participation: The female labor force as a percentage of the total labor force (OECD 1960–1995).

Financial openness: Financial openness is measured as the sum of the index for restrictions on payments and receipts of goods and invisibles, the index for restrictions on payments and receipts of capital, and the index for legal international agreements that constrain a nation's ability to restrict exchange and capital flows. Values for 1994 and 1995 were extrapolated (Armingeon, Beyeler, and Menegale 2000).

GDP growth: GDP growth is measured as year-to-year percentage changes (OECD electronic database; OECD 1960–1995).

Government consumption: Goods and services consumed by the government, except military spending (Iversen and Cusack 2000).

Government debt: Government debt is measured as the level of consolidated central government debt as a percentage of GDP (Franzese 1998).

Government partisanship: The source for all countries but Japan is McDonald and Mendes (2001). Data for Japan were created by the author using the Comparative Manifesto Project's left-right party index and Woldendorp, Keman, and Budge (2000).

International openness: International openness is measured as imports plus exports as a percentage of GDP (OECD electronic database; OECD 1960–1995).

Minimum wages: The ratio of the statutory minimum wage to the average wage (Neumark and Wascher 1999). For countries where the government does not set the minimum wage, the ratio of the minimum wage to the average wage is set to zero. Following David Neumark and William Wascher (1999), Dolado et al. (1996), and OECD (1998), Canada, France, Japan, the Netherlands, the United Kingdom, and the United States are considered to have statutory minimum wages. In Australia, Austria, Belgium, Denmark, Finland, Germany, Italy, Norway, and Sweden, the ratio of the statutory minimum wage to the average wage is considered to be zero.

Private service employment: Service employment as a percentage of total employment minus government employment as a percentage of total employment (OECD 1960–1995).

Public sector employment: Government employees (not including employees of state-owned enterprises) as a percentage of the total employed labor force (OECD electronic database; OECD 1960–1995).

Taxes on labor and corporations: The tax on corporate income represents taxes on the corporate income, profits, and capital gains of individuals. The data were compiled by Thomas R. Cusack (see also Cusack and Beramendi 2003).

Trade with less-developed countries: Trade with less-developed countries as a percentage of GDP, not including trade with OPEC countries (OECD electronic database; OECD 1960–1995; OECD, *Monthly Trade Statistics*).

Unemployment: Unemployment is measured as a percentage of the total labor force. (OECD electronic database; OECD 1960–1995).

Union density: Employed union members as a percentage of the employed labor force ("net density") for all countries but Canada. The Canadian figures include unemployed and retired people who retain their membership in the numerator and the unemployed in the denominator ("gross density") (Visser 1996).

Table 6A.1 Regression Results for Figure 6.2

	Minimum Wage	Government Consumption	Taxes on Labor	Taxes on Corporations
Determinants of policy				
Cabinet partisanship	**.0010301**	**.0256197**	**.0438422**	**.9371027**
	(.000482)	(.007376)	(.0136908)	(1.29744)
	.033	*.001*	*.001*	*.470*
Cabinet partisanship* corporatism	**–.0013645**	**–.0289719**	**–.0597766**	**–4.95936**
	(.0007139)	(.0140254)	(.0310418)	(5.002042)
	.056	*.039*	*.054*	*.321*
Corporatism	**.0230247**	**1.030228**	**–6.688961**	**263.9869**
	(.0544388)	(1.389138)	(3.042322)	(492.8069)
	.672	*.458*	*.028*	*.592*
Union density	**.0034848**	**.0382604**	**.0117861**	**–2.492325**
	(.000822)	(.0153101)	(.0296078)	(4.270994)
	.000	*.012*	*.691*	*.560*
Wage-bargaining centralization	**.0785674**	**1.484446**	**9.384893**	**172.2172**
	(.0546315)	(1.010216)	(2.31408)	(288.3194)
	.150	*.142*	*.000*	*.550*
International openness	**–.0001998**	**–.0122439**	**–.0726906**	**–1.926598**
	(.0003365)	(.0100618)	(.0224608)	(1.951015)
	.553	*.224*	*.001*	*.323*
Financial openness	**–.0004002**	**.1246415**	**.0544854**	**–7.32711**
	(.0022044)	(.0446082)	(.1084007)	(7.456081)
	.856	*.005*	*.615*	*.326*
Government debt	**–.0007041**	**–.4073702**	**14.49643**	**–31.62622**
	(.0248975)	(.4629413)	(1.015794)	(112.0451)
	.977	*.379*	*.000*	*.778*
Unemployment rate	**.0007135**	**.3371956**	**.3443517**	**4.600955**
	(.0015534)	(.0317582)	(.0692177)	(5.94565)
	.646	*.000*	*.000*	*.439*
GDP growth	**–.000106**	**–.1332531**	**–.1201857**	**1.108425**
	(.0011732)	(.0225736)	(.0499664)	(4.208872)
	.928	*.000*	*.016*	*.792*
Constant	**–.2021842**	**9.406055**	**8.273959**	**160.97**
	(.0639506)	(1.178893)	(2.396136)	(215.8107)
	.002	*.000*	*.001*	*.456*
Observations	329	348	338	329
R-squared	.9747	.9502	.9624	.0480

Table 6A.1 Continued

	Minimum Wage	Government Consumption	Taxes on Labor	Taxes on Corporations
Determinants of inequality				
Policy (specified in first row)	**−.1991474**	**−.0140506**	**.0015068**	**−.0013982**
	(.0993088)	(.0061321)	(.002595)	(.0004463)
	.064	*.022*	*.561*	*.002*
Policy*corporatism	**.3736833**	**.0215531**	**−.0021971**	**.0014108**
	(.2466455)	(.0079391)	(.0034897)	(.0004508)
	.130	*.007*	*.529*	*.002*
Corporatism	**−.0363871**	**−.3670438**	**.1190394**	**−.0495208**
	(.0632842)	(.1695945)	(.1688838)	(.0664126)
	.565	*.030*	*.481*	*.456*
Unemployment rate	**−.0019291**	**−.002412**	**−.0026831**	**−.0032901**
	(.0016245)	(.0014569)	(.001495)	(.0016331)
	.235	*.098*	*.073*	*.044*
Trade with less-developed countries	**.006031**	**.0098622**	**.0064025**	**.0060687**
	(.0029678)	(.0030503)	(.0029502)	(.0029734)
	.042	*.001*	*.030*	*.041*
Female labor force participation	**.0056115**	**.0009731**	**.0026306**	**.0024898**
	(.0036816)	(.0033987)	(.002697)	(.0029058)
	.127	*.775*	*.329*	*.392*
Private service sector	**−.0031868**	**.0005268**	**−.0013548**	**−.0020748**
	(.0020111)	(.0020229)	(.0018421)	(.0017882)
	.113	*.795*	*.462*	*.246*
Union density	**−.0003537**	**−.0001588**	**−.0004433**	**−.0010562**
	(.0011775)	(.0011472)	(.0011684)	(.0012177)
	.764	*.890*	*.704*	*.386*
Wage-bargaining centralization	**−.2712495**	**−.3284604**	**−.3387357**	**−.408379**
	(.0715453)	(.0642466)	(.0685666)	(.0691053)
	.000	*.000*	*.000*	*.000*
Public-sector employment	**−.01108**	**−.0126009**	**−.01225**	**−.0115403**
	(.0023847)	(.0029683)	(.0028719)	(.0022338)
	.000	*.000*	*.000*	*.000*
Constant	**2.004856**	**2.292805**	**2.068716**	**2.255708**
	(.1572161)	(.1926206)	(.1619231)	(.1633958)
	.000	*.000*	*.000*	*.000*
Observations	219	222	222	213
R-squared	.9763	.9767	.9756	.9758

Source: Author's compilation; see appendix for variable details and data sources.

Note: All entries are OLS estimates. Numbers in bold are estimated coefficients; numbers in parentheses are their panel-corrected standard errors; numbers in italics are p-values from two-sided t-tests. Estimates for country dummies are not reported.

Notes

1. I use a similar methodological setup and the same control variables as those used by Pontusson, Rueda, and Way (2002).
2. I ran the regressions without a constant.
3. The periods are 1973 to 1979, 1980 to 1984, 1985 to 1989, and 1991 to 1995. The excluded reference year is 1990.
4. The average level of earnings replacement provided by public unemployment insurance during the first year of unemployment. For more details, see OECD (1994, pt. 2, chap. 8).
5. The prerequisites for unemployment benefits differ substantially in OECD nations. As a consequence, there is great variation in terms of the percentage of unemployed people who receive benefits (see, for example, Blöndal and Pearson 1995).
6. Corporatism encapsulates a number of economic characteristics, including: the centralization and coordination of unions, business, and wage-setting; cooperation between government and interest groups; the existence of tripartite organizations; and a degree of cooperation among economic actors. I use a measure provided by Alexander Hicks and Lane Kenworthy (1998). See the appendix for details.
7. See the appendix for details and sources about all of the variables used in this chapter's analysis.
8. For a more detailed analysis of some of the options, see John Huber and Bingham Powell (1994).
9. For evidence supporting the idea that a government's behavior is influenced by its share of seats in parliament, see Wolfgang Müller and Kaare Strøm (2000).
10. Data from party manifestos can be criticized for being a reflection of what parties say to win elections and not necessarily what they will do once they have won them. For an analysis arguing that there is a correlation between party platforms and policy in the American case, see Ian Budge and Richard Hofferbert (1990).
11. To simplify the interpretation of my results I have reversed the index. Higher values of this variable therefore indicate governments to the left, and lower values governments to the right.
12. If there is only one party in government, its cabinet weight is 100 percent. When there is more than one party in government, a party's weight is given by its proportion of parliamentary seats within the total number of seats held by the coalition parties. There is considerable evidence that "governments apportion their cabinet portfolios to parties in simple proportion to the relative percentage of seats held by each in the lower house of the legislature" (Powell 2000, 173; see also Laver and Schofield 1990).
13. As with other ratios, the use of this measure introduces the question of

whether the causes (or the effects) that are observed are related to a change in the minimum wage or in the average wage.

14. Government consumption consists of goods and services (except military spending). See the appendix for details.
15. Government consumption is also related to public employment, which can be used by policymakers to support egalitarian wage policies. For details, see Torben Iversen and Thomas Cusack (2000, 329).
16. However, this relationship may have ambiguous results. It may compress wages by increasing those of the bottom tenth percentile, or it may expand them by increasing the wage of the median worker even more.
17. Government consumption is a very aggregate measure, and it could be considered to include at least three kinds of distinct policies: government employment, welfare state spending, and services like health and education. Given the length of the analysis and the already high number of policies in it, a more disaggregated approach cannot be adopted in this chapter. But see David Rueda (forthcoming) for a separate analysis of government employment and welfare state spending and its implications for the arguments presented in this chapter.
18. Political economists have analyzed the politics of government expenditures and their effects on inequality in much more detail than the redistributive effects of taxation. This chapter attempts a more balanced approach.
19. There is also evidence, however, contradicting this framework. See Duane Swank and Sven Steinmo (2002), Geoffrey Garrett and Deborah Mitchell (2001), and Garrett (1998).
20. The countries are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Japan, the Netherlands, Norway, Sweden, Switzerland, the United Kingdom, and the United States.
21. My results are confirmed in regressions without panel-corrected standard errors.
22. Since the corporatism variable does not display a great degree of variance over time, I confirm the validity of the results by reestimating the models using random effects. All the substantive findings are corroborated by the random effects analysis.
23. The analysis includes linearly interpolated data for a handful of missing observations in the wage inequality series. I did not interpolate across gaps of more than three years, and interpolated observations account for only thirteen out of those used in the analyses (more than two hundred).
24. The measure of corporatism used in this chapter is not highly correlated with union density (correlation coefficient = .507) and bargaining centralization (correlation coefficient = .702).
25. One interpretation of the policy changes of the early 1980s, for example, is that many governments had reached unsustainable levels of public debt (Schwartz 1994).

26. For more details about calculating conditional effects and their significance, see Jeffrey Wooldrige (2000, 190–91).
27. For an analysis that endogenizes labor market coordination in a model that explores the relationships among business, labor, and government partisanship, see Marco Hernandez and David Rueda (2007).

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